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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 485

THE LONDON AND OVERSEAS INSURANCE CO., *et al.*,
Petitioners,

v.

BUNGE CORPORATION and BROOKS BANKER, as Treasurer of AMERICAN EXPRESS COMPANY,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT BROOKS BANKER, AS TREASURER OF AMERICAN EXPRESS COMPANY, IN OPPOSITION

QUESTION PRESENTED

Whether a defendant-insurer which has denied liability to its insured can, by exercising its procedural right to implead a third party, deprive its insured of the power to make a settlement with and give a general release to such third party where the insurer has made no payment to its insured and has not become subrogated to any of its insured's rights.

STATUTE INVOLVED

Although the motion below was one for summary judgment and decided on fundamental principles of substantive law, petitioners claim that the statute involved is the procedural impleader rule, Rule 14(a) of the Federal Rules of Civil Procedure, which they set forth at pages 2-4 of their petition. Respondent submits that Rule 14(a) cannot affect the determination of such a motion in view of 28 U. S. C. § 2072, the first two paragraphs of which provide:

> "The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Courts of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.
>
> "Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution."

STATEMENT

This action arises out of the discovery in November, 1963, of a major fraud, perpetrated by Allied Crude Vegetable Oil Refining Corporation ("Allied") and its president, Anthony DeAngelis (98a).[1]

The Allied-DeAngelis fraud involved improper removal of or failure to deposit commodities certified by Allied to have been stored with American Express Warehous-

[1]All references are to pages of the appendix in the Court below unless otherwise indicated. All emphasis is supplied throughout unless otherwise indicated.

ing, Ltd. ("Limited"), a wholly-owned subsidiary of American Express Company ("Amexco"), the theft and forgery of blank warehouse receipt forms of Limited, and the forgery of delivery orders presented to Limited. Respondent Bunge, the plaintiff in this action, is one of many companies that claimed substantial losses as a result of Allied's fraud (98a).

Immediately after the discovery of the Allied-DeAngelis fraud Amexco stated that while it had no legal liability in the matter it felt morally bound to do everything it could, consistent with its overall responsibilities, to see that the liabilities of its warehousing subsidiaries were satisfied (100a; *Heimann* v. *American Express Co.*, 53 Misc. 2d 749, 753, 767 (Sup. Ct. N. Y. Co. 1967)). After long negotiations a comprehensive proposal was made for the settlement of litigation and potential litigation by warehouse receipt claimants calling for the payment by Amexco of approximately $60,000,000. The proposal was signed by Bunge on September 15, 1965 and on October 15, 1965 it became a binding agreement on Amexco, Bunge and almost all claimants under warehouse receipts issued or purportedly issued by Amexco's present and former warehousing subsidiaries. The agreement provided that upon consummation of the settlement Amexco would be released from all claims of Bunge or any subrogee of Bunge based upon the warehouse receipts.[2] After the satisfaction of all conditions precedent, the settlement was consummated on June 14, 1967 (101a).

Prior thereto, on November 12, 1964, Bunge commenced the primary action at bar, alleging that certain vegetable oil covered by warehouse receipts issued by Limited to Bunge was converted by Allied or others and

[2] Excerpts from the specific terms of the release are set forth in Amexco's moving affidavit in the District Court (101a) and are quoted in the District Court's opinion (204a-206a and pp. 12a-15a of appendix to petition).

that such oil was covered by the insurance contracts issued by petitioners (4a-27a). The insurers admitted the execution and delivery of the insurance contracts, denied most of the remaining allegations of the complaint and asserted a number of affirmative defenses, including the defense that the insurance contracts were void because of alleged concealment and nondisclosure of facts by the insured (40a-46a). The insurers made no payment to Bunge and have consistently disclaimed all liability on the insurance contracts (179a-181a).

On December 21, 1964, the insurers impleaded Amexco. The sole basis of the insurers' claim against Amexco is that they will be subrogated to Bunge's rights against Amexco in the event they are compelled to pay Bunge (47a-49a, 99a).

On June 29, 1965, Bunge and Amexco obtained an order of the District Court staying all proceedings until October 1, 1965, in anticipation of the settlement becoming a binding contract (58a-64a, 74a-76a). After the settlement agreement was signed, all proceedings in the third-party action were stayed until further order of the District Court and that stay remained in effect for approximately two years. From the inception, in granting these stays, the District Court made it clear that once the settlement was consummated there would be no subrogation rights to which the insurer could succeed, that the third-party action would have to be dismissed when Bunge's release became effective, and that in the meantime the agreement preventing Bunge from suing Amexco pending the consummation of the settlement was binding on the insuers (74a, 89a-94a).

After the settlement was consummated, Amexco moved for summary judgment on the ground that the potential subrogation rights asserted in the third-party complaint had been extinguished by Bunge's release of Amexco (95a-107a). Amexco's motion was granted on December 14,

1967 (199a);[3] and the District Court also dismissed the primary action although no formal motion for such relief had been made. The Court of Appeals for the Second Circuit affirmed the District Court as to the third-party action and reversed it as to the primary action.[4] On June 10, 1968, petitions for rehearing and rehearing *en banc* were denied.

ARGUMENT

1. Petitioners have shown no reason whatsoever why this Court should grant certiorari. The Court below correctly decided the issue before it on the basis of thoroughly settled fundamental principles of both state and Federal law:

a. Prior to payment an insured is the sole owner of his claims against third parties and his insurer has no rights in those claims. *Meredith* v. *The Ionian Trader*, 279 F. 2d 471, 474 (2d Cir. 1960); *Glens Falls Ins. Co.* v. *Wood*, 8 N. Y. 2d 409, 412 (1960); *American Sur. Co.* v. *Diamond*, 1 N. Y. 2d 594, 598 (1956); *American Sur. Co.* v. *Palmer*, 240 N. Y. 63, 67 (1925); *American Sur. Co.* v. *Gerold*, 255 App. Div. 285, 287 (1st Dep't 1938).

b. Upon payment the insurer has the right "to step into the shoes of" the insured, but is "subject to all legal and equitable defenses which the third party may have against the [insured]." *Hartford Acc. & Indem. Co.* v. *First Nat'l Bank & Trust Co.*, 287 F. 2d 69, 72 (10th Cir. 1961); *Insurance Co. of N. America* v. *Morgan Dyeing & Bleaching Co.*, 262 F. 2d 916, 919 (7th Cir.

[3] 64 Civ. No. 6440 (S. D. N. Y.). Opinion reproduced in appendix to the petition, pp. 8a-21a.

[4] 394 F. 2d 496 (1968). Opinion reproduced in appendix to the petition, pp. 1a-5a.

1959); see also *United States* v. *Munsey Trust Co.*, 332 U. S. 234, 242 (1947); *Phoenix Ins. Co.* v. *Erie & W. Transp. Co.*, 117 U. S. 312, 321-22 (1886); *Wanamaker* v. *Otis Elevator Co.*, 228 N. Y. 192, 201 (1920); *Northern Assur. Co.* v. *Wolk*, 182 Misc. 112, 114 (App. T. 1944), *aff'd*, 269 App. Div. 768 (1st Dep't 1945).

The subrogee is bound by any limitations on its subrogor's rights, whether they arise by operation of law or by reason of acts or omissions of the subrogor. *Phoenix Ins. Co.* v. *Erie & W. Transp. Co., supra; Fayerweather* v. *Phenix Ins. Co.*, 118 N. Y. 324 (1890); *Platt* v. *Richmond, Y. R. & C. R. R.*, 108 N. Y. 358 (1888); *Mercantile Mut. Ins. Co.* v. *Calebs*, 20 N. Y. 173 (1859); *Northwestern Fire & Marine Ins. Co.* v. *Fred T. Ley & Co.*, 238 App. Div. 255 (4th Dep't 1933), *aff'd*, 264 N. Y. 427 (1934); *Jersey Ins. Co.* v. *Parrish*, 33 N. Y. S. 2d 440 (Erie Co. Ct. 1942).

The "rights of . . . subrogees can rise no higher than their source", *Beecher* v. *Leavenworth State Bank*, 192 F. 2d 10, 14 (9th Cir. 1951), *cert. denied*, 343 U. S. 953 (1952).[5] Consequently, when an insured has released his rights against a third party prior to any payment by the insurer, the insurer cannot thereafter succeed by way of subrogation to the rights the insured previously held. As Professor Vance notes:

[5] *E.g.*, a subrogee is bound by a statute limiting the liability of a third party to the subrogor [*Liberty Mut. Ins. Co.* v. *Sheila-Lynn, Inc.*, 185 Misc. 689 (App. T. 1945), *aff'd*, 270 App. Div. 835 (1st Dep't, 1946)]; a subrogee is bound by its subrogor's contributory negligence and breach of contract [*Maryland Cas. Co.* v. *Independent Metal Prods. Co.*, 99 F. Supp. 862 (D. Neb. 1951) (alternative holding), *aff'd*, 203 F. 2d 838 (8th Cir. 1953) (contributory negligence); *Potomac Ins. Co.* v. *Stanley*, 281 F. 2d 775 (7th Cir. 1960) (breach of contract); *Casualty Co.* v. *A. L. Swett Elec. Light & Power Co.*, 230 N. Y. 199 (1920)]; a subrogee is bound by a holding that a third party is not obligated to the subrogor [*Sexauer & Lemke* v. *Luke A. Burke & Sons Co.*, 228 N. Y. 341 (1920) (Cardozo, J.); *Wanamaker* v. *Otis Elevator Co., supra*, 228 N. Y. 192].

> "... [A] tort-feasor who in good faith and without any knowledge of any *payment* by the insurer to the insured does settle with the insured, may set up this fact as a bar to the insurer's action for subrogation." *Vance, Insurance* 794 (3d ed. 1951)

2. Petitioners have failed to show any conflict with the substantive law of New York. They completely misconceive the nature of the right of subrogation and ignore the distinction between cases involving knowledge on the part of the tortfeasor that an insurer has made payment under the policy and cases where the insurer has refused to make payment. This is demonstrated by *Krause* v. *American Guar. & Liab. Ins. Co.*, 22 N. Y. 2d 147 (1968), on which petitioners rely (petition, pp. 12-13). In that case, which also arose out of the Allied-DeAngelis fraud, the New York Court of Appeals allowed impleader prior to payment by the insurer, thus bringing the New York procedural law in line with Federal practice, but specifically noted that such impleader would *not* deprive the insured of the power to settle with and release the impleaded party. The court said:

> "The insured is free to press on with its claim or, if no payment has been made by the insurer, settle as the insured desires." (22 N. Y. 2d at 154)

Impleader of a third party by an insurer does no more than put that party on notice of the existence of insurance and the insurer's intention to assert its potential subrogation rights if it is compelled to make payment to its insured. But such knowledge does not prevent an insured from giving a valid release to a third party which extinguishes all potential subrogation rights. *Seligson* v. *Fidelity & Cas. Co.* v. *American Express Co.*, N. Y. L. J., Dec. 2, 1966, p. 16, col. 3; Apr. 5, 1967, p. 18, col. 1; June 26, 1967, p. 15, col.

6; July 18, 1968, p. 2, col. 4 (Sup. Ct. N. Y. Co.)[6] See *Ocean Acc. & Guar. Corp.* v. *Hooker Electrochemical Co.*, 240 N. Y. 37, 47-48 (1925); *Pacific Fire Ins. Co.* v. *L.A.D. Motors Corp.*, 136 Misc. 594 (City Ct. N. Y. 1930).

Petitioners' reliance on a dictum in *Silinsky* v. *State-Wide Ins. Co.*, 30 App. Div. 2d 1 (2d Dep't 1968), is misplaced. That dictum is not supported by the cases cited by the Appellate Division which all involved situations where the tortfeasor knew prior to settlement that the insurer had made *actual payment*. Furthermore the dictum is in direct conflict with the earlier decisions of New York's highest court cited at pages 5-6, *supra*, and the *subsequent* decision by that court in *Krause* v. *American Guar. & Liab. Ins. Co.*, *supra*, where as noted the court specifically stated that despite impleader by the insurer—and thus knowledge on the part of the releasee of the existence of insurance—the insured remained free to "settle as the insured desires". (See p. 7, *supra*)

Were the law otherwise, an alleged tortfeasor would remain exposed to further claims with respect to the same subject matter by subrogees of the injured party and would hardly be likely to make a substantial settlement. The insured would thus be deprived of an opportunity to promptly recoup at least part of his losses. This cannot be the law, nor is it.[7]

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[6] These New York decisions by two different justices of the New York Supreme Court also involved the Allied-DeAngelis fraud and rejected contentions of an insurer that it was not bound by the settlement agreement between its insured and Amexco.

[7] Indeed, the law so strongly protects a third party who settles with an insured that, even where the insurer's subrogation rights have vested by payment to the insured, the third party, who thereafter settles in good faith without knowledge of the fact or reason to suspect that the insurer has made payment, is protected from suit by the insurer. *Ocean Acc. & Guar. Corp.* v. *Hooker Electrochemical Co.*, *supra*, 240 N. Y. at 47.

Petitioners also rely upon *Connecticut Fire Ins. Co.* v. *Erie Ry.*, 73 N. Y. 399 (1878) to show a conflict with the substantive law of New York. That case however, does not support their argument. It involved a settlement by an insured and a release which *specifically preserved* the insured's rights against his insurer. The court held that this clause in the release "was in the nature of a proviso or exception from the general purview of the release" (73 N. Y. at 404) and that all that was intended to be settled was the wrongdoer's liability to the insured *in excess* of the insured's coverage. By contrast, the case at bar involves a general and unqualified release and it is undisputed that the release was intended to extinguish all of Bunge's claims against Amexco. In fact, the settlement agreement provided an option to an acceptor to except from the release rights which an insurer might derive by way of subrogation upon payment. Bunge did not exercise that option. The findings of the District Court on this point, which were affirmed by the Court of Appeals, are not challenged (206a-208a, pp. 14a-16a of appendix to petition).

The precise issue here involved, on identical facts, was decided by the New York Supreme Court on September 30, 1968, in *Scarburgh Company, Inc.* v. *Employers' Surplus Lines Insurance Company and American Manufacturers Mutual Insurance Company* v. *American Express Company*, N. Y. L. J., Oct. 4, 1968, p. 17, col. 3. In that action another acceptor of the Amexco settlement had brought an action against its insurance carriers which, in turn, had impleaded Amexco. The court pointed out that Scarburgh accepted the settlement without exercising the option to preserve any potential rights of its insurers against Amexco and that Scarburgh's intent to give a complete release to Amexco extinguishing such rights was clear. The court

obviously found the rationale and decision of the Court of Appeals for the Second Circuit in the case at bar entirely in accord with the substantive law of New York, quoted from it with approval, and said:

> "When an insurance company repudiates liability, it breaches its contract of insurance and thereby frees the insured to press on with its claim. If no payment has been made by its insurer, the assured may settle with the third party as it desires (Matter of Vanguard Ins. Co., 18 N. Y. 2d 376).
>
> * * *
>
> "By refusing to make payment upon a contract of indemnity the insurer has not perfected its right of subrogation. Subrogation is not perfected until *after* payment, whereupon the insurer succeeds to whatever rights then had by its insured (Comm. Fire Ins. Co. v. Erie Railway Co., 73 N. Y. 399). (Emphasis in original)
>
> * * *
>
> "Because the third-party complaints against Amexco by each of the insurance companies are predicated upon claims of subrogation the motions made by Amexco for summary judgment dismissing the third-party complaints are granted for the reason that the court finds that the rights to subrogation have been extinguished by the release provision between Scarburgh and Amexco."

3. Petitioners have failed to show any conflict with decisions of the Second or other Circuits. They argue that because they were allowed to implead Amexco under Rule 14(a) of the Rules of Civil Procedure, Bunge could not give Amexco a full release because it could not destroy potential

subrogation rights. There is no merit to this contention. While Rule 14(a) may accelerate the time when a potential right may be asserted for procedural purposes, it is well settled that it does not in any way affect substantive rights or create a substantive right where none exists. 28 U. S. C. § 2072 clearly provides that the rules of civil procedure "shall not abridge, enlarge or modify any substantive right." *United States* v. *Sherwood,* 312 U. S. 584, 590 (1941); *Travelers Ins. Co.* v. *Busy Elec. Co.,* 294 F. 2d 139, 146 (5th Cir. 1961); *Smith* v. *Whitmore,* 270 F. 2d 741, 745 (3d Cir. 1959); *Behar* v. *Savard,* 21 F. R. D. 367, 369 (S. D. N. Y. 1958); 3 *Moore, Federal Practice* ¶ 14.03, p. 491 (2d ed.). Impleader therefore cannot deprive the sole owner of a claim of the power to release it.

Petitioners rely on *Glens Falls Ind. Co.* v. *Atlantic Building Corp.,* 199 F. 2d 60 (4th Cir. 1952), and *St. Paul Fire & Marine Ins. Co.* v. *United States Lines Co.,* 258 F. 2d 374 (2d Cir. 1958), *cert. denied,* 359 U. S. 910 (1959) in support of their claim of conflict between Circuit Court decisions. All that these cases hold is that prior to payment an insurer may implead an alleged tortfeasor. They do not suggest in any way that impleader of a third party prevents an insured from completely releasing that third party. In *Meredith* v. *The Ionian Trader, supra,* 279 F. 2d at 475, the Second Circuit specifically pointed out that its prior decision in *St. Paul* did not mean that substantive rights of subrogation had been changed by the impleader rule.

In sum, petitioners have failed to show any conflict between Circuits or with the substantive law of New York and it is clear that none exists. The decision below is in accord with the fundamental principle of law that until an insurer makes payment, its insured remains the sole owner of any claim against a third party and has the right to release that claim and thereby extinguish potential subrogation rights.

CONCLUSION

FOR THE FOREGOING REASONS, IT IS RESPECTFULLY SUBMITTED THAT THE PETITION FOR A WRIT OF CERTIORARI SHOULD BE DENIED.

Respectfully submitted,

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Dated: New York, New York
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